Legislative Department
Seattle City Council
Memorandum

Date: December 8, 2010

To: City Light Review Panel

From: Tony Kilduff

Subject: City Light's 2011-2012 Budget and Rates

I understand from Karen Reed that some of you have expressed a desire for a summary of the budget and rate actions the Council took during the 2010 review of the 2011-2012 budget and rates, and the thinking behind those actions.

Mayor's Proposal

The Mayor had proposed a two-year budget for City Light that assumed:

- For 2011, a 4.3% increase in average retail rates and $110.5 million in net revenue from the sale of surplus power in the wholesale market; and
- For 2012, an additional 4.2% rate increase and approximately $102 million in net wholesale revenue.

The level of budget authority (i.e., legal expenditure authority) for the two years reflected these revenue assumptions, and of course, assumptions around new borrowing in 2011 ($210 million) and other miscellaneous sources of revenue.

The net wholesale revenue targets included in these budgets for 2011 and 2012 are dictated by the ordinance that established the funding for the Rate Stabilization Account (RSA), so the Mayor (and City Light) had no choice in the matter[i].

In the end, the Council approved rate increases of 4.3% for 2011 and 3.2% for 2012. However, it made several changes to the budgets in both years along the way. I will discuss these below, but first I want to note a change the Council made to City Light rates that was not an amendment to the Mayor's proposed rates.

Rate Surcharge

As you are all aware, the Council acted in March of this year to impose a surcharge of 4.5%, beginning in May, to build the RSA. Other sources were the existing $25 million in the reserve fund and the 2010 share of the savings in debt service from refinancing around $500 million of outstanding City Light debt at lower rates (around $32 million).

The RSA ordinance requires that the Account reach $100 million before (a) initial surcharge comes off, and (b) City Light can begin to rely on it to make up shortfalls in net wholesale revenues. City Light anticipated that the Account balance would reach $69 million by the end of 2010, but that it would not reach the required $100 million until the middle of 2011. However, by diverting around $10 million in operating cash from 2010 to the Account and recognizing the 2011 refinancing savings essentially on January 1 instead of as they occur through the year, the utility could get the balance to $100 million by January 1, 2011. This allows the surcharge to come off January 1. The Council directed the utility to take the necessary actions and reduced its rate revenue in the 2011 budget to reflect the removal of the surcharge. The Mayor concurred.

This action by the Council warrants a number of comments.

- The Council chose to do this because it is keenly aware that these are very difficult times for City Light customers, especially for those businesses that depend heavily on power for their success. By removing the surcharge at the same time that the base rates increase by about the same amount, the Council hoped to ease the transition to higher base rates in 2011.
- The Council recognized that the surcharge may well return in 2011 at some level (more on this later), but it wanted to provide ratepayers with whatever rate relief was possible for as long as possible.
- Diverting $10 million in 2010 operating revenue into the RSA is not trivial for City Light. Having failed to realize nearly $70 million in net wholesale revenue this year, "losing" another $10 million to the RSA (where it is not available to the utility) is significant. It also lowers its debt service coverage to 1.7 instead of the 1.8 required by Council policy, and that will not be appreciated by the rating agencies. However, the utility and the Mayor were convinced doing this was the right thing for the rate payers and the risks of a negative response from the agencies was small.

Council Budget Actions

Although the Council approved the Mayor's proposed rate increase for 2011, it reduced City Light's 2011 operating budget by approximately $13.6 million. About $8 million of that came from the decision by City Light, after the budget was developed, not to exercise its right to purchase power from the Priest Rapids project. This lowered its costs. The remainder was from a combination of cuts to programs, abrogating 14 vacant positions, and from savings, relative to the proposed budget, realized by the Power Marketing Unit in meeting I-937 targets. (Kudos to the PMU).

Normally, reductions in operating cost would translate into reductions in rates and rate revenue. However, on the recommendation of staff the Council chose to reduce the assumed level of net wholesale revenue from $110.5 million to about $97 million. All indications are that City Light will earn substantially less than $110 million in net wholesale revenues in 2011. Natural gas futures remain low, and even if City Light has healthy generation in 2011, as promised by La Niña, it is unlikely to make up the revenue on volume[ii].

To see the impact of using the reductions in costs to lower the assumed net wholesale revenue in 2011, notice that (a) the imposition and size of any surcharge depends on the balance in the RSA, and (b) City Light will withdraw shortfalls in actual net wholesale revenue relative to the target from the RSA each quarter starting in 2011. (It will also deposit any excess relative to target.) Clearly, the lower the target the less likely City Light is to withdraw from the RSA and therefore the less likely there will be a surcharge in 2011. And if there is a surcharge, it will be lower the lower the target[iii].

The savings in 2012 could similarly have been used to lower the net wholesale revenue target in that year. And there is a good argument for that—the $102 million figure is also likely too high. However, the Council chose to use the savings to lower the proposed rate increase from 4.2% to 3.2%.

Endnotes

[i] The ordinance specifies that the amount will be the average of the realized revenues from 2002 to the last complete year. That determines 2011, and given a fairly solid estimate of 2010 revenue, forms the basis for 2012.

[ii] La Niña can be a mixed blessing. Too much precipitation can lead to the threat of flooding and mitigating actions by the Corps of Engineers that actually lowers generation.

[iii] The triggers on the surcharge are: 1.5% if the Account goes below $90 million; 3% if it goes below $80 million; and 4.5% if it goes below $70 million.